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Master's Thesis on

Corporate Groups and their Regulation in Georgia

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Abbreviations

CoA	The Court of Appeals
Current version of the law	The Law of Georgia on Entrepreneurs Effective until 1 January 2020, №578–IS, Legislative Herald of Georgia №577, 28/10/1994
Etc.	et cetera: and other similar things
E.g.	Exempli gratia, for example
EMCA	European Model Companies Act
EU	European Union
IFRS	International Financial and Reporting Standards
JSC	Joint Stock Company
LLC	Limited Liability Company
New version of the law	The Law of Georgia on Entrepreneurs Effective from 1 January 2020, № 875-VRS-XMP, Legislative Herald of Georgia, 02/08/2021
Outside shareholder	Minority shareholders if the subsidiary company
Registry	National Agency of Public Registry
SCG	The Supreme Court of Georgia
The Decision	The decision of the Chamber of Civil Cases of the Supreme Court of Georgia №AS-1319-2018 , dated 21 May 2021
UK	United Kingdom
Vs.	Versus

Abstract

While many countries around the world have acknowledged that corporate groups differ from a single company and therefore require specific regulation, Georgia seems to leg behind. The study of corporate groups here is almost non-existent. The aim of this paper is to explore and present challenges that are particularly characteristic to corporate groups and provide recommendations for their regulation in Georgia. With a view to reconcile the law with reality, the object of recommendations is to assist the efficient and effective management of corporate groups, while ensuring appropriate protection for minority shareholders and outsiders. The paper is based on the ample scientific research conducted in both Anglo-American and civil law countries. Situation in Georgia is analysed in the light of the latest Supreme Court Decisions. The study has shown that there is a huge gap in Georgian corporate law where the regulation of corporate groups should be.

Introduction

Organisation of business through a single company has become obsolete. Corporate groups occupy the modern globalized market now[1] and most of them are multinational[2], with subsidiaries in several different jurisdictions. Even from the nationwide perspective, organization of business through corporate groups is becoming increasingly common. Such structures serve several different purposes. Some corporations use this mechanism to externalise the risk of liability by setting up legally separate subsidiaries, although the corporations themselves earn profit from the activities that generate risk[3]. Cigarette manufacturers actually admitted that they created holding companies to "*better insulate each business from obligations and liabilities incurred in unrelated activities*.[4]" Group structure is also a useful tool for expansion as it generates numerous efficiency gains and gives companies the opportunity to develop large global enterprise.

Irrespective of the reasons for its formation, it carries with it several challenges, which if not regulated may lead to negative outcomes. These outcomes may manifest in two ways: hindrance

[1] See, Blumberg, "The Transformation of Modern Corporate Law: The Law of Corporate Groups", 2005, p.606; See also: Klaus J. Hopt, Groups of Companies A Comparatie Study on the Economics, Law and Regulation of Corporate Groups, Working Paper № 286/2015, February 2015, p.2.

[2] See Klaus J. Hopt, Groups of Companies A Comparatie Study on the Economics, Law and Regulation of Corporate Groups, Working Paper № 286/2015, February 2015, p.2.

[3] See Valery Fedchuk, "Modern Legal Regulation of Corporate Groups in National Private Law", see the citation: J.E. ANTUNES, Liability of Corporate Groups (1994); M.J. ROE, "Corporate Strategic Reaction to Mass Tort", 72 Virginia Law Review 1 (1986), 39.

[4] Id. See the citation: HANSMANN / KRAAKMAN, supra note 6, at 1881 & n. 3.

to the group's efficient management and damage to stakeholders. Therefore, the regulation of major issues, like the group management, transparency, protection of minority shareholders and creditors are crucially important.

Group regulation under corporate law generally aims to: (1) protect outside shareholders and creditors;[5] (2) assist businesses and the economy by recognizing corporate group as organizational form and by facilitating group management[6]. Which aim to focus on is up to the policy makers of each individual state. This paper proposes a regulation that supports the efficient management of groups, while, at the same time, provides sufficient guarantees for creditors and shareholders.

The paper is structured in following parts: the first and the second part are more informative and explain the essence of the topic. Part 1 illustrates the concept and function of the group, its main characteristics. Part 2 analyses major challenges associated with group structure with the aim to present how corporate group differs from a single company. Part 3 reviews the international experience, setting forth the brief overview of four different approaches of regulating groups that can be observed worldwide. Part 4 is an analytical portion of the paper. In light of the existing legal framework, it analyses the major gaps in Corporate Law and proposes possible tools to remedy the gap.

1 The Concept and Function of the Corporate Group

1.1 The Concept of the Corporate Group

Corporate groups dominate the modern world[7]. As stated in the 2011 Report of the Reflection Group *"the international group of companies – not the single company – has become the prevailing form of European large-sized enterprises, which business activity is typically organised and conducted through a network of individual subsidiaries located in several States inside and outside Europe"* [8]. We all know the giants like Google Inc., Samsung, HP Inc., Johnson & Johnson, Amazon, Facebook, Apple Inc., Hyundai and many others. They are all organised as corporate groups[9], with a parent company and several subsidiaries intertwined in many different ways.

[5] See Klaus J. Hopt, "Groups of Companies A Comparative Study on the Economics, Law and Regulation of Corporate Groups", Working Paper № 286/2015, February 2015, p.3.
[6] Id.
[7] See Blumberg, "The Transformation of Modern Corporate Law: The Law of Corporate Groups", 2005, p.608;
[8] Report of the Reflection Group On the Future of EU Company Law, Brussels, 5 April 2011, p. 59, available at: https://ssrn.com/abstract=1851654.
[9] For example, Alphabet (GOOGL) see https://www.forbes.com/companies/alphabet/?list=global2000/&sh=12b10380540e; Johnson & Johnson (JNJ)

Aside from operating under a common name, what are corporate groups? Philip Blumberg whose primary area of expertise was the legal problems of large corporations[10] describes them as "*enterprises organized in the form of a dominant parent corporation with scores or hundreds of subservient sub holding, subsidiary, and affiliated companies. These typically conduct a single integrated enterprise under common control and often under a common public persona"*.[11] The words "dominant" and "subservient" in this description reveal what is unusual, problematic and interesting about corporate groups.[12]

The definition of corporate group varies in different jurisdictions. The key defining characteristic is typically common ownership.[13] The prototypical corporate group includes a parent company, its direct and indirect subsidiaries and affiliates, each with a separate legal personality.[14]

Another strongly related criterion is control.[15] "Control" is defined as the ownership of a majority voting rights, with relevant powers attached to it, most importantly the power to appoint board members.[16] Although control may also be conferred contractually.[17] So, as we can see, the Control maybe established by the mere fact of holding certain percentage of shares in a company (factual control) or by the existence of an actual (substantive) control assessed in accordance with established factors.[18]

An additional element, that has guided the courts in veil-piercing context or when applying enterprise principles to groups is the consideration of whether related entities function as a

see https://www.forbes.com/companies/johnson-johnson/?list=global2000/&sh=7cd723384f91; Facebook see https://www.forbes.com/companies/facebook/?list=global2000/&sh=9972d434193e.

[10] Professor Philip I. Blumberg has done the most extensive research on corporate groups. Blumberg is the author of a seven-volume series, The Law of Corporate Groups and the co-author of a five-volume treatise, Blumberg on Corporate Groups, see. https://www.law.uconn.edu/faculty/profiles/phillip-i-blumberg#.

[11] Blumberg, "The Transformation of Modern Corporate Law: The Law of Corporate Groups", 2005, p.606.

[12] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p.827.

[13] See Virginia Harper Ho, "Theories of Corporate Groups: Corporate Identity Reconceived", 2012, Seton Hall Law Review: Vol. 42 : Iss. 3 , Article 2, p. 886.

[14] Id.

[15] Id., p.888; see also, Klaus J. Hopt, "Groups of Companies A Comparative Study on the Economics, Law and Regulation of Corporate Groups", Working Paper № 286/2015, February 2015, p. 2-3.

[16] See Kahn v Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1113-14 (Del. 1994).

[17] See Blumberg, "The Transformation of Modern Corporate Law: The Law of Corporate Groups", 2005, p. 304-06, 343-44.

[18] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p.827.

[18] See Virginia Harper Ho, "Theories of Corporate Groups: Corporate Identity Reconceived", 2012, Seton Hall Law Review: Vol. 42 : Iss. 3 , Article 2, p. 889.

single integrated enterprise.[19] Economic and decisional integration is relevant in determining whether independent entities should be viewed as a single enterprise.[20]

When independent legal entities are managed as *"a single integrated enterprise under common control and often under a common public persona,"*[21] by equity participation or contractual obligations, tensions between independence and interdependence arise. Most of these tensions manifest themselves as particular problems in the law of corporate groups: "*Directors must pursue the good of their corporation, so how may they sacrifice this good for the well-being of the entire group? Directors must exercise independent judgment, so how may they be forced to follow instructions from the management of their holding company?"*[22]

The definition of control differs around the world and so does the degree of control exercised by the parent companies upon their subsidiaries. Higher the degree of control, more problematic the regulation of the group. The main reason for this is that, in such circumstances members of the group remain separate legal entities, while in realty they do not function as such.

1.2 The Function of the Corporate Group

The main function of the group is its utilization in the firm's aspiration for growth. Economies of scale and scope that come with the expansion drive companies to create the whole net of affiliated companies[23]. Uniting closely related products and sharing inputs provides considerable benefits to the group. Synergies and efficiencies gained through transactions and allocations of resources among companies within the group provide security and reduce the need to rely on outside sources[24]. Direct allocation of inputs trough firms reduces transaction costs associated with contracting across markets[25]. These advantages are even stronger in the context of less developed economies, where weak enforcement, asymmetric information and greater difficulty to enforce contracts favours groups, which are able to benefit from the

[19] Id.
[20] Id., p. 890.
[21] See the citation above;
[22] Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 828.
[23] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 829.
[24] See Corporate Governance of Company Groups: International and Latin American Experience, Latin American Roundtable, Task Force on Corporate Governance of Company Groups, 17 November, 2014, see http://www.oecd.org/daf/ca/latinamericanroundtableoncorporategovernance.htm, para. 10.
[25] See Cristopher W. Frost, "Organizational Form, Misappropriation Risk, and the Substantive Consolidation of Corporate Groups", Hastings Law Journal, Vol. 44, No. 3 (March 1993), p. 471.

lower transaction costs available through intragroup transactions[26]. In this case, it is more efficient and less costly to integrate and secure long-term financing and/or access to key production inputs internally rather to rely on external markets.

Chandler[27] discusses four methods to expend from a single company to a corporate group – 1.Acquire or merge with enterprises using the same processes to make the same products for the same markets (to grow by horizontal combination); 2. Take on units involved in the earlier or later stages of making a product (from the mining or processing of raw materials to the final assembling or packaging) (to grow by vertical integration); 3. Expand geographically to distant areas; 4. Make new products that are related to the firm's existing technologies or markets.[28]

These methods not necessarily require the existence of a corporate group, but in practice usually lead to its creation. This is so, because besides an opportunity for growth group structure also provides limited liability. In the group context, this creates several layers of limited liability, sheltering the parent corporation as well as the shareholders of the parent.[29] In a single corporation, liabilities incurred by an unprofitable division may drain the profits of the entire business and drive the corporation into insolvency.[30] By dividing the parts of the enterprise into separate legal entities, risks from each part are isolated within the separated entity while the rest of the enterprise may remain unaffected.[31] Thus, limited liability, originally designed to encourage capital investments by individuals, has become a tool driving the organization of large multi-company enterprises[32].

Another important function of the group is that it allows for control of large enterprise with comparatively little capital[33]. If a parent company acquires 50.1% of the shares of the subsidiary, it can determine all shareholder decisions that require only a simple majority of the votes and, hence, effectively exercise control over the subsidiary. If, in turn, the subsidiary

[26] See Kirkpatrick, G. (2004), "Corporate Governance and company groups: considerations from the OECD Principles". Paper presented at the KDI Conference on Corporate Governance of Group Companies, Seoul – November 2004; see also Sang Yop Kang, "Rethinking Self-Dealing and the Fairness Standard: A Law and Economics Framework for Internal Transactions in Corporate Groups," Virginia Law and Business Review 11, no. 1 (Fall 2016), p. 99 and 107-108.

[27] Professor of business history at Harvard Business School and Johns Hopkins University, he wrote extensively about the scale and the management structures of modern corporations.

[28] See Chandler, Alfred D. Jr. 1990, Scale and Scope: The Dynamics of Industrial Capitalism (The Belknap Press of Harvard University Press), p. 37.

[29] See Phillip I. Blumberg, "Limited Liability and Corporate Groups", 11 J. Corp. L. 573, 608 (1986).

[30] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 829.

[31] Id.

[32] Id.

[33] Id, p. 830.

acquires 50.1% of another corporation, parent company's control extends to that corporation even though its total investment amounts to little more than 25% of its equity.

These are the major advantages that corporate groups provide and the main reasons for choosing to organize business as a group instead of a single company.

Of course, there are costs and potential risks associated with group structure. Conflicts of interest between majority and minority shareholders or between companies within the group may threaten the efficiency of firms and their competitiveness.[34] Furthermore, the absence of good corporate governance, a lack of transparency regarding the ownership structure and the possibility of abuse by the majority shareholder, as well as the costs of monitoring internal transactions, make it difficult for affected parties to identify and measure instances when their interests may be damaged and to request redress.[35]

The existence of sound regulations and corporate governance standards can mitigate such costs and risks to some extent.

2 Major Challenges

The decision to structure an enterprise as a corporate group rather than as a single company is not only a matter of business decision making and convenience, but can heavily effect the governance of a shareholder's investment.[36] The factors that make a group structure attractive for a parent company can cause concern to other stakeholders,[37] most importantly to outside shareholders and creditors.

The management of the group itself poses a dilemma. In this respect, the major question is - in whose interests should the management conduct the business. The company it serves? The parent company? The entire group?

The ability to shift resources and transact within groups with less transaction costs creates conflicts of interests between the shareholders on different tiers of the group. Limited liability, providing several layers of protection to the group, insulating each separate entity from liability creates concerns for creditors, considering that while activities of subsidiaries are conducted in

[34] See Corporate Governance of Company Groups: International and Latin American Experience, Latin American Roundtable, Task Force on Corporate Governance of Company Groups, 17 November 2014, available at http://www.oecd.org/daf/ca/latinamericanroundtableoncorporategovernance.htm, para. 11.
[35] Id. para. 12.
[36] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 831.
[37] Id. p. 830.

the interest of the whole group, liability arising from these activities is limited to the assets of the individual subsidiary[38].

Following sections of this part of the paper will discuss these concerns. First section deals with the group interest, while the second breaks down the agency problems.

2.1 Group Interest

In a single, independent company, the focus of director's fiduciary duties is clear. Directors owe their duties to the company they serve. This situation gets blurry when several interconnected companies are involved.

As mentioned above, the reality of corporate group is different from a single company, because the parent company is generally in the driver's seat, deciding the activities of the whole group and directing the management of subsidiaries.[39] This reality has caused a significant debate in almost all jurisdictions[40] - the issue is whether the directors of a subsidiary can permit some disadvantage to the subsidiary in the pursuit of the interests of the group, without having to compensate for this damage immediately, or within a short time period, and to the full amount. In other words, whether the directors of the subsidiary can promote the overall group interest or are their fiduciary duties limited to the company they serve. The same question arises with respect to the directors of the parent company as well.

Recognition of the group interest would create a *"safe harbour"* for the managers of both, parent and subsidiary companies against liability if they take action for a group member considering the existence of a group as a unitary business entity.[41] Most importantly, in the case of instructions from a parent company to take action in the interests of the group as a whole but arguably not in the interests of that particular company.[42]

In a cross border context, this means more certainty and flexibility for the parent company to direct the economic activities of the whole group in subsidiaries with places of business in several different countries. This way the directors of subsidiaries could be relieved of their

[38] Id.
[39] See, for example, Corporations and Markets Advisory Committee, "Corporate Duties Below Board Level Report, April 2006: *" The reality of modern public companies is that they are managed and controlled at a group level . . . with executives often employed by a subsidiary once or twice removed from the main listed entity*", at p. 74.
[40] See EMCA, 2017, 1st Edition, p. 371-72.
[41] See, Report of the Reflection Group On the Future of EU Company Law, Brussels, 5 April 2011, p. 60, available at: https://ssrn.com/abstract=1851654.
[42] Id.

duties under domestic laws to act in the *"best interests of the company"* they are serving and could rely on the *"best interests of the group"*[43].

In any case, such flexibility requires adequate safeguards for different stakeholders, most importantly for outside shareholders and creditors. The circumstances in which the group defence is available requires careful consideration as well.

2.2 Agency problems

There are three main agency problems to be dealt with in corporate law: conflicts between managers and shareholders, conflicts among shareholders (essentially between the controlling shareholder and the minority shareholders), and conflicts between the shareholders as a group and stakeholders.[44] For the parent in a group of companies, the agency conflict between managers and shareholders is hardly relevant, as the controlling shareholder ultimately prevails against the management.[45] In the parent company - by voting power at the general assembly, and in the subsidiary - by superior influence on the board.[46] Therefore, this type of agency conflict is not particularly pertinent in groups. Hence, in groups of companies, the two relevant principal-agent conflicts concern the minority shareholders and the creditors.

2.2.1 Controlling Shareholders vs. Minority Shareholders

The controlling shareholder may abuse that control position in various ways, such as self-dealing and similar related party transactions, thereby reaping private benefits of control.[47] Different provision of corporate law, which are rarely drawn up with corporate groups in mind, typically deal with such opportunistic behaviour. As we will see in the following parts of this paper, many jurisdictions cope with this agency problem without distinguishing whether these conflicts arise in a single company or in a group of companies. Yet in groups of companies, this agency problem has several particular characteristics[48].

First, it must be noted that the transfer of value from the subsidiary to its parent or other related corporations through pricing arrangements for goods and/or services, as well as the taking of the subsidiary's corporate opportunities, may be harder to detect than in a single corporation

[43] Id.
[44] See Klaus J. Hopt, "Groups of Companies A Comparative Study on the Economics, Law and Regulation of Corporate Groups", Working Paper № 286/2015, February 2015, p.4.
[45] Id.
[46] Id.
[47] Id. p. 5.
[48] See Cf. German Monopolies Commission, biannual reports on economic concentration; on concentration in Germany, Volker Emmerich/Mathias Habersack, KONZERNRECHT, 10th ed., Munich 2013, § 1 III 3 and in more detail for German group law infra II B.

where conveyances to a dominant shareholder will usually be more obvious.[49] This can present significant dangers for the minority shareholders of a subsidiary. Even if we stir this situation from the presumption of bad faith on the part of the controlling shareholder, it still poses a challenging problem. The controlling shareholder in the subsidiary may act responsibly in the interest not only of the parent, but of the group as a whole and/or other subsidiaries[50]. Of course, the controlling shareholder itself also has an interest in the well-being of its subsidiary. However, this does not reduce the risk of opportunism in a group if the controlling shareholder has important stakes in other companies as a parent of the group or as a controlling shareholder of the parent.[51] Based on distorted pricing, a controlling shareholder can determine the terms and conditions of an internal transaction in favour of an affiliate where it has more economic interests, and to the detriment of the affiliate where it has less economic interest.[52] In this case, what may be disadvantageous for the controlling shareholder in one company may at the same time be beneficial for him/her/it in other companies.[53] This makes agency problems in a corporate group much more relevant.

Second, governance of a group requires much more difficult balancing of interests between the subsidiary and the parent (and other subsidiaries) than between the minority and the majority in a single corporation. This is so, because as mentioned in the previous paragraph, group structure inherently poses difficult business decisions that may be appropriate or even necessary for the group though disadvantageous or even harmful for the subsidiary. Examples of these are not hard to find – a parent company may require goods/services readily available and at discounted prices from the subsidiary, which leaves the later in financial difficulties[54]; due to the parent's necessity of the cash flow the whole earnings of the subsidiary may be distributed for profits, while for the subsidiary reinvestment for growth may be more advisable. As Klaus J. Hopt[55] points out: *"it is very common that the parent takes contributions from the*

[49] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 830.
[50] See Klaus J. Hopt, "Groups of Companies A Comparative Study on the Economics, Law and Regulation of Corporate Groups", Working Paper № 286/2015, February 2015, p. 5.
[51] Id.
[52] See Sang Yop Kang, "Rethinking Self-Dealing and the Fairness Standard: A Law and Economics Framework for Internal Transactions in Corporate Groups," Virginia Law and Business Review 11, no. 1 (Fall 2016), p. 98.
[53] See Klaus J. Hopt, "Groups of Companies A Comparative Study on the Economics, Law and Regulation of Corporate Groups", Working Paper № 286/2015, February 2015, p. 5.
[54] This is what happened in the famous US case Sinclair Oil Corporation v. Francis S. Levien, Supreme Court of Delaware, 280 A 2d 717 (1971).
[55] Emeritus (Director) at the Max Planck Institute for Comparative and International Private Law, Hamburg, Main Fields of Research: German and European corporate, capital markets, commercial, banking, and business law, see more at https://www.mpipriv.de/1075772/klaus-j-hopt.

subsidiaries for the group that may or may not be economically and/or legally justified from the perspective of the subsidiary, for example for services rendered within the group or more generally for the alleged benefits of belonging to the group[56]*".* This is one of the major reasons for treating corporate groups separately in many jurisdictions.

Third, the agency problem is aggravated if the controlling shareholder in the group holds only a percentage of shares that is enough for control instead of 100%[57] or even holds the controlling interests without the equity of the corresponding value[58]. Depending on how control is defined, this may be 51%, or even considerably less in corporations where the attendance rate of the shareholders at the general assembly is low[59] or in corporations where the controlling interest is obtained through special types of shares (like golden shares) or voting leverage schemes (e.g., circular shareholding)[60]. This can also happen when the control over a subsidiary is exercised by another subsidiary and so on. These structures allow controlling shareholders to drive a wedge between voting rights and cash-flow rights.[61] The actual economic stake of the controlling shareholder at the top of the hierarchy may thus become very small, with the consequence that its risk in the lowest part may be minimal[62]. This divergence has been documented in academic research to increase the incentive and tendency of the controlling shareholder to seek and reap private benefits of control[63].

Fourth, in a group of companies, the agency conflict may also concern the minority shareholders in the parent corporation. This can happen, when the veto rights of the minority with respect to actions requiring supermajority approval are undermined by setting up a holding structure

[56] Klaus J. Hopt, "Groups of Companies A Comparative Study on the Economics, Law and Regulation of Corporate Groups", Working Paper № 286/2015, February 2015, p. 5;
[57] See Luca Enriques/Paolo Volpin, "Corporate Governance Reforms in Continental Europe", 21 Journal of Economic Perspectives 117 (2007), pp. 122-125.
[58] For more information regarding the gap of a controlling shareholder's ownership in two affiliates and its possible negative impacts see: Sang Yop Kang, "Rethinking Self-Dealing and the Fairness Standard: A Law and Economics Framework for Internal Transactions in Corporate Groups," Virginia Law and Business Review 11, no. 1 (Fall 2016): 95-148.
[59] See Klaus J. Hopt, "Groups of Companies A Comparative Study on the Economics, Law and Regulation of Corporate Groups", Working Paper № 286/2015, February 2015, p. 6.
[60] On voting leverage mechanisms see Lucian A. Bebchuk et. Al., "Stock, Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights", Vol: Concentrated Corporate Ownership 295:318 (Rendall K. Morck ed., 2000), http://nber.org/chapters/c9013.pdf.
[61] See Corporate Governance of Company Groups: International and Latin American Experience, Latin American Roundtable, Task Force on Corporate Governance of Company Groups, 17 November 2014, see http://www.oecd.org/daf/ca/latinamericanroundtableoncorporategovernance.htm, para. 15.
[62] See Klaus J. Hopt, "Groups of Companies A Comparative Study on the Economics, Law and Regulation of Corporate Groups", Working Paper № 286/2015, February 2015, p. 6.
[63] See Corporate Governance of Company Groups: International and Latin American Experience, Latin American Roundtable, Task Force on Corporate Governance of Company Groups, 17 November 2014, see http://www.oecd.org/daf/ca/latinamericanroundtableoncorporategovernance.htm, para. 15.

where the main activities are carried out by the subsidiary and the parent merely acts as a holding company.[64] Parent's management, usually elected by no more than a simple majority of the votes, exercises parent's voting rights in the subsidiaries. Hence, by virtue of its influence over the parent's management, a dominant shareholder of the parent company controls decisions on matters in subsidiary corporations that parent's minority would have the ability to veto in many circumstances[65].

2.2.2 Controlling Shareholders vs. Creditors

Just like minority shareholders, creditors of corporate groups are more exposed to controlling shareholder opportunism than creditors of a single, independent company.[66] The special features discussed above also apply here (lesser incentive of the controlling shareholder to act in the sole interest of the subsidiary because of its stakes in other companies, difficult decisions in governing the whole group, agency problems not only for the creditors of the subsidiary but also for the creditors of the parent).[67]

Furthermore, in the group setting, even voluntary creditors generally able to contract around the risks are subject to additional constraints. This is so, because it is more difficult for a creditor of a subsidiary to evaluate the risks than for a creditor of a single company. Legal separation and accompanying limited liability of group members, accelerates agency conflicts,[68] the situation is simply more opaque, and the divisions between the assets of group members are more blurred.[69] Creditors must correctly perceive and assess the riskiness of contracting with the group member to demand the appropriate compensation.[70]

Dickfos[71] points out two main types of risk that are accentuated in this case:

[64] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 831.
[65] Id.
[66] See Reinier Kraakman/John Armour/Paul Davies/Luca Enriques/Henry Hansmann/Gerard Hertig/Klaus Hopt/Hideki Kanda/Edward Rock, THE ANATOMY OF CORPORATE LAW, Oxford 2d ed. 2009, p. 127-128.
[67] See Klaus J. Hopt, "Groups of Companies A Comparative Study on the Economics, Law and Regulation of Corporate Groups", Working Paper № 286/2015, February 2015, p. 7.
[68] See Dickfos, jennifer, "Enterprise Liability for Corporate Groups: A More Efficient Outcome for Creditors", Australian Journal of Corporate Law, 2011, p. 247; see http://www.lexisnexis.com.au/en-au/products/australian-journal-of-corporate-law.page.
[69] Id.
[70] Id. p. 246;
[71] Senior Lecturer at Griffith Business School, one of the areas of research expertise in corporate groups, see https://www.griffith.edu.au/griffith-business-school/departments/accounting-finance-economics/contact-us/jennifer-dickfos

1. Limited recourse risk (non-payment because of limited liability) increased where shareholders or directors can misrepresent value of corporate assets of the group members by falsely ascribing the ownership of assets to one member, while in reality assets belong to another member of the group. Creditors are simply unable to determine *"where the boundaries of asset partitioning lie"*[72]. The use of corporate group branding and intra-group financing further blurs the lines between the members of the groups – the former helps to exploit the relationship between corporate group members, while the later has been identified[73] as a means of concealing true financial position of the member of the group from creditors.

2. Debtor opportunism risk that *"after the terms of the transaction are set the debtor will take increased risk, to the detriment of the lender*[74]*".* This is the case, when subsequent to contracting the debt, intra-group financing enable assets to be drained or additional liabilities incurred by a group member. The controlling shareholder's lack of any duty in dealing with the subsidiary means that a creditor is unable to make an accurate assessment of the risk because *"the possible range of the parent's conduct is very wide*[75]*"*.

This is true irrespective of whether the creditor knows that the company it is contracting with is a group member or not. As Klaus J. Hopt points out, disclosure under the various national and international rules is relatively well established with respect to the parent corporation (due to group accounting), but its less developed with respect to subsidiaries.[76] Hence, the general creditor risk is higher in groups than in single companies.

3 Regulation of Corporate Groups

Corporate groups are regulated by several different areas of law, such as accounting[77], tax[78], competition[79] and others. Each of these laws address the fact that, although the units of the

[72] See Dickfos, jennifer, "Enterprise Liability for Corporate Groups: A More Efficient Outcome for Creditors", Australian Journal of Corporate Law, 2011 p. 248;
[73] See T. Hadden, "The Regulation of Corporate Groups in Australia", 15 UNSW Law Journal, 1992, p. 65.
[74] F. H. Easterbrook and D. I. R. Fischel, "The Economic Structure of Corporate Law", 1st edition, Harvard University Press, Cambridge, 1991, pp 52.
[75] R. Schulte, "Corporate Groups and the Equitable Subordination of Claims on Insolvency", 18(1) Company Lawyer, 1997, p. 18.
[76] See Klaus J. Hopt, "Groups of Companies A Comparative Study on the Economics, Law and Regulation of Corporate Groups", Working Paper № 286/2015, February 2015, p. 7.
[77] E.g. the issue of submitting consolidated accounts for groups.
[78] E.g. taxation of related party (intra-group) transactions.
[79] E.g. the concept of a single economic entity.

group are legally separate entities, they operate in a unified group that is generally guided by central management.[80]

There are four major approaches with respect to regulating corporate groups: comprehensive regulation, partial regulation, case law recognition of the interest of the group and lack of treatment.[81] The first approach originates in Germany and envisages a comprehensive regulation of groups.[82] A second approach envisages a partial or selective regulation dealing with some major questions without aiming to regulate groups in a complete and comprehensive manner.[83] This is the case of Italy. The third approach is the French one and originates from the *Rozenblum* decision of the French Supreme Court.[84] Some countries have no specific regulations on groups. In this case, groups are governed by the same rules that apply to single companies.

Following part of this chapter will demonstrate these approaches using the legal framework existing in the countries that follow it. Finally, it will discuss the overall approach with respect to groups on the EU level.

3.1 Comprehensive Regulation - Germany

Germany has pioneered a statutory system with respect to groups of companies (*Konzernrecht – hereinafter the "Group Law")* that seeks to balance the interest of the group and that of its associated companies[85] and in which a parent and subsidiary are, in certain circumstances, treated as a single economic unit.[86] The system ties liability to the parent company's ability to exercise control over its subsidiaries.[87] Several jurisdictions like Portugal, Hungary, Czech Republic and Slovenia have adopted the German model (more or less)[88].

[80] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 831-32.
[81] See EMCA, 2017, 1st Edition, p. 371.
[82] Id.
[83] Id.
[84] Id.
[85] See Corporate Governance of Company Groups: International and Latin American Experience, Latin American Roundtable, Task Force on Corporate Governance of Company Groups, 17 November 2014, para. 26.
[86] See J.E. ANTUNES, Liability of Corporate Groups (1994); M.J. ROE, "Corporate Strategic Reaction to Mass Tort", 72 Virginia Law Review 1 (1986), p. 314.
[87] See W. SHETEWY, A Preferable Approach toward the Parent-Subsidiary Relationship (1984) (unpublished S.J.D. dissertation, University of California, Berkeley, School of Law) (on file with Law Library, University of California, Berkeley).
[88] See, Report of the Reflection Group On the Future of EU Company Law, Brussels, 5 April 2011, p. 59, available at: https://ssrn.com/abstract=1851654.

German *Group Law* overrides other mandatory provisions of the SCA and allows for the fundamental characteristics of the corporation to be altered, to achieve in practice the benefits of the group structure, such as creating an "internal capital market" to allocate resources among the group members[89].

German *Group Law* is incorporated in the SCA. These rules are designed for the protection of the subsidiary's minority shareholders and creditors, while at the same time determine the latitude for legally permissible group integration.[90] An understanding that general rules on minority protection are insufficient if a controlling shareholder has substantial business interests besides the stake in the controlled corporation (because the controlling shareholder may have an incentive to damage the corporation for the sake of promoting these other business interests) is the basis of the German *Group Law*[91].

The practical effect of these provisions is that they allow an independent corporate entity and its management to develop into a unit of a larger group and serve within it, as well as to *"provide specific safeguards to protect the most vulnerable constituencies in this arrangement"*[92]. Corporate groups under German law may be formed in two ways: expressly, by contract referred to as "*enterprise agreement*" or in fact (de facto) by actual influence[93].

3.1.1 Enterprise Agreements

Enterprise agreements may subject a subsidiary company to the instructions of its parent (control agreement) or divert all or part of the profit of the subsidiary to the parent (profit and loss absorption agreement).[94] Control agreement, among other things, grants the right to manage the controlled corporation via direct instructions issued to its management board.[95] Unless agreed otherwise, these directions may be detrimental to the company if they serve the interests of the controlling enterprise or the whole group.[96] The range of such instructions is non-exhaustive, and could include orders to forgo corporate opportunities, make discount deliveries,

[89] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 832.
[90] See Tobias H. Troger, "Corporate Groups", SAFE Working Paper No. 66 September 22, 2014, p.6.
[91] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 834.
[92] Id.
[93] Id.
[94] Section 291(1) of the German SCA, official translation of the act can be found here -http://www.gesetze-im-internet.de/englisch_aktg/.
[95] Section 308(1) of the German SCA.
[96] Id.

transfer proprietary information, and perform services without compensation.[97] Pursuant to majority view among German commentators, the ability to issue binding instructions is constrained by the requirement that such instructions should not threaten the controlled corporation's existence.[98]

Profit and loss absorption agreement requires the transferring corporation to divert all or part of its profits to the recipient corporation[99], while at the same time obliges parent to compensate the subsidiary for all losses incurred during the existence of the agreement, regardless of their cause.[100]

Structural changes that the conclusion of a control contract entails is reflected in the stringent prerequisites that have to be met in drawing-up and concluding such an agreement[101] as well as in the safeguards and protections that support the interests of minority shareholders[102] and creditors[103] once the control of a parent has been established.

To conclude, the control agreement emphasizes the enabling function of organizational law, as it permits broad measures of group integration[104]. However, the corresponding safeguards for minority shareholders and creditors balance the controlling shareholder's leeway.

3.1.2 De Facto Groups

When a controlling parent is present without an enterprise agreement between the parties, it is referred to as a "de facto" concern.[105] The statutory key to whether two or more companies have formed a de facto concern is the existence of domination/dependence relationship as defined in

[97] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 836;
[98] See Tobias H. Troger, "Corporate Groups", SAFE Working Paper No. 66 September 22, 2014, p.9;
[99] Section 291(1) of the German SCA;
[100] Section 302 of the German SCA.
[101] Control agreement has to be approved by a supermajority vote (section 293(1)(2) of the German SCA), furthermore the management board has to prepare a detailed report on the contract and its main aspects (section 293a(1) of the German SCA) and contract has to be audited as well (section 293b(1) of the German SCA).
[102] Minority shareholders are protected e.g. by sell-out rights (section 305 of the German SCA), the minority shareholders of the subsidiary may also demand to receive a guaranteed dividend (section 304 of the German SCA).
[103] Creditors are protected e.g. by the controlling firm's obligation to compensate for the controlled corporation's losses under the profit and loss absorption agreement (section 302(1) of the German SCA), creditors of the subsidiary can also demand the posting of security for outstanding debts upon termination of the agreement (section 303 of the German SCA).
[104] See Tobias H. Troger, "Corporate Groups", SAFE Working Paper No. 66 September 22, 2014, p. 10.
[105] Section 311 of the German SCA.

section 17 of the German SCA[106]. The provision specifies that the primary evidence of such a relationship is the ability to directly or indirectly exert a controlling influence,[107] the section also states that a majority ownership interest creates a presumption of such influence.[108] Law does not include guidance on other circumstances that would create a controlling influence. The policy behind the regulation of de facto groups is that, where any person through controlling influence has the capacity to cause conflicts between the duty of the subsidiary's management to serve the subsidiary's best interests and the influence of the controlling person, legal safeguards should be available.[109] If there is a controlling influence, the provisions of SCA regulating de facto groups will apply.

One of such provisions is that where no control agreement exists, a controlling enterprise may not use its influence to incite a controlled enterprise to enter into a legal transaction detrimental to it, or to take or refrain from measures resulting in a disadvantage, unless the disadvantages are compensated.[110] If the controlling enterprise fails to provide timely compensation it is liable for damages to the controlled enterprise jointly and severally with its representatives that actually induced the adverse measures.[111] The controlled enterprise's management board can bring direct claims, while its individual shareholders[112] and creditors[113] (when the controlled enterprise is in default) can initiate a derivative action.

"The outlined regime basically takes a protective stance that seeks to limit controlling shareholder's adverse influence and mitigate agency conflicts"[114]. Although the fundamental duty of loyalty is still considerably modified by the possibility to provide compensation for disadvantages within a year.[115]

3.2 Partial Regulation - Italy

While there is no comprehensive regulation of corporate groups in Italy, there are pieces of legislation that considers the phenomena.[116]

[106] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 837.
[107] Section 17(1) of the German SCA.
[108] Section 17(2) of the German SCA.
[109] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p. 838.
[110] Section 311(1) of the German SCA.
[111] Section 317 of the German SCA.
[112] Section 309(4)(1)(2) and 317(5) of the German SCA.
[113] Section 309(4)(3) and 317(5) of the German SCA.
[114] Tobias H. Troger, "Corporate Groups", SAFE Working Paper No. 66 September 22, 2014, p. 8.
[115] Id.
[116] See Valery Fedchuk, "Modern Legal Regulation of Corporate Groups in National Private Law", 2012, p. 567.

The Italian Civil Code never refers to "groups", but regulates situations in which a corporation exercises "direction and coordination" over other companies[117]. Law creates a direct cause of action against a parent corporation by either the subsidiary's shareholders or its creditors to protect them when such entity is not operated in compliance with *"principles of correct company and business management*".[118] At the same time, Italian case law acknowledges an overall economic "group concept", *"permitting parent companies to assert an affirmative defence that any damages suffered by the subsidiary were offset by other transactions or the totality of benefits resulting from the direction and coordination of the parent company"*[119].

Actions taken under the direction and coordination of the parent are subject to the following transparency requirements: (a) detailed disclosure of the justification for such transactions; (b) annual report disclosure of the company's relationships with other group members and illustration of their impact on its management and results; (c) disclosure that the subsidiary was subject to the direction and coordination of the parent.[120]

3.3 Case Law Recognition of the Interest of the Group - France

A number of European countries have adopted the concept of providing greater leeway to the holding company to manage the overall interests of the group through court case jurisprudence that has resulted in the application of the "*Rozenblum Doctrine*", followed in France, Belgium and to some extent in Italy.[121]

The doctrine softens the general approach by allowing some room for directors, in the exercise of their fiduciary duties to balance the current cost of supporting other group companies with the longer-term potential benefits of group membership.[122] The *Rozenblum* doctrine originated from a case in the French Court of Cassation. Although the case concerned a criminal matter, the reasoning of the court is applied in civil cases for violation of the duty of loyalty of subsidiary company directors who take into account the interests of the parent company when making decisions.[123] Conditions under which a director may apply a "group defence" regarding

[117] Id., p. 568.
[118] See, OECD Library, "Overview of the legal/regulatory framework with respect to the duties and responsibilities of boards in company groups", https://www.oecd-ilibrary.org//sites/55ea4b91-en/index.html?itemId=/content/component/55ea4b91-en#boxsection-d1e2051.
[119] Id.
[120] Id.
[121] Id. para. 29.
[122] See, OECD Library, "Overview of the legal/regulatory framework with respect to the duties and responsibilities of boards in company groups", https://www.oecd-ilibrary.org/sites/55ea4b91-en/index.html?itemId=/content/component/55ea4b91-en;
[123] Id.

the duty of loyalty for a decision that is not in the direct interests of the subsidiary company are the following:

> *"(i) The businesses of the companies are carried out within a coherent group policy; (ii) the directors believe their actions will advance the interests of the group; (iii) the compensation is not grossly inadequate; and (iv) the actions will not bring about the effective insolvency of the subsidiary*[124]*".*

Later court cases in France and Belgium have reaffirmed the notion that directors' duty of loyalty may extend to the group under certain conditions.[125] *Rozenblum doctrine*—or a similar formulation—has gained wider popularity in subsequent years[126].

3.4 The Lack of Treatment

3.4.1 United Kingdom

The UK has many laws that affect groups but no law on groups as such.[127] Although for tax and accounting purposes groups are commonly treated as one unit, the courts are reluctant to disregard the separate legal personality of the members of the group.[128] The governance of groups therefore depends on how the regulations that deal with general company law issues affect groups.

Similar to the German approach, UK law also provides a possibility to conclude a "control contract", which confers a right that *"(a) is of a kind authorised by the articles of the undertaking in relation to which the right is exercisable, and (b) is permitted by the law under which that undertaking is established.*"[129] Unlike the German approach, this type of contract does not override the mandatory provisions of the general corporate law - articles of a subsidiary may be drafted to convey control powers to a parent company unless these powers contradict or disregard what has been "permitted by law". Thus, UK companies are free to set up interlocking structures to the extent that their operation do not infringe rights otherwise guaranteed.[130]

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[124] Id.
[125] See Corporate Governance of Company Groups: International and Latin American Experience, Latin American Roundtable, Task Force on Corporate Governance of Company Groups, 17 November 2014, para. 33.
[126] See The Informal Company Law Expert Group (ICLEG), Report on the Recognition of the Interest of the Group, October 2016, p. 25.
[127] See Janet Dine, "The Governance of Corporate Groups", Cambridge University Press 2000, p. 44.
[128] Id.
[129] Companies Act 2006, Schedule 7, para. 4(2).
[130] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p.840.

In the UK, the fiduciary duties of directors and boards relate solely to the company itself and not to its parent or the group at large.[131] However, the directors of the subsidiary are still able to consider the interests of the group in deciding what will promote the company's success for the benefit of its members.[132] Whether this involves a breach of the director's duties can be resolved by the resolution of the shareholders that approve the action proposed.[133] The rules on wrongful trading limit the directors' latitude in the case of insolvency.[134] Therefore, they will be very careful not to prefer the interests of the group to the interests of the creditors of the company if the company may become insolvent.

3.4.2 United States of America (Delaware law)

Delaware law, similarly to UK, contains no rules on the regulation of corporate groups and follows the traditional approach to director's duties, i.e. fiduciary duties of directors and boards relate solely to the company itself.[135] However, Delaware law allows significantly more leeway for freedom of contract in parent-subsidiary dealings; the flexibility of the law allows the parties to adapt their constitutional documents to the desired framework of governance.[136] Under the General Corporation Law of Delaware "*the business and affairs of every corporation… shall be managed by or under the direction of a board of directors, except as may be otherwise provided… in its certificate of incorporation"*[137]. Furthermore, if such provisions are indeed made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors *"shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation"*[138]. This allows a parent to manage the subsidiary itself, as a majority shareholder. Fiduciary duties of the dominant

[131] See, OECD Library, "Overview of the legal/regulatory framework with respect to the duties and responsibilities of boards in company groups".
[132] 2011 European Commission "Report of the Reflection Group on the Future of EU Company Law" advised that "The EU Commission should consider, subject to evidence that it would be a benefit to take action at the EU level, to adopt a recommendation recognising the interest of the group" See p. 63.
The report is available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1851654.
[133] Id.
[134] See Section 214 of the UK Insolvency Act 1986, available at https://www.legislation.gov.uk/ukpga/1986/45/contents:
[135] See, OECD Library, "Overview of the legal/regulatory framework with respect to the duties and responsibilities of boards in company groups".
[136] See Andreas Cahn and David C. Donald, "Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA", Second edition, Cambridge University Press, 2018, p.841;
[137] Delaware General Corporate Law, Title 8, Chapter 1, Subchapter IV, § 141(a), available at https://delcode.delaware.gov/title8/c001/index.html;
[138] Id.

company (the burden to prove the entire fairness of the transaction[139]) and the fiduciary duties of the subsidiary's board of directors safeguard such a free structure.

3.5 The Case of the EU

Although there have been several attempts at the EU level to create coherent and systemized group law, all have turned out to be futile due to the substantial differences in member states.[140] The past attempts show the general tendency – preference to the targeted modifications and additions instead of codifying a law for corporate groups that largely supersedes general corporate law.[141] Initiatives on the European level have mostly supported the group interest, while at the same time providing sufficient safeguards for creditors and outside shareholders.[142] Even if the momentum behind the recognition of the group interest is recurring, the idea has found overwhelming support among academics.[143]

EMCA, drafted by company law experts from several Member States,[144] could become a relevant force for developing rules on groups of companies.[145] It is designed to inspire the Member States and to promote an EU wide soft harmonisation; it can be regarded as "*a tool for better regulation in the EU"*[146], as well as a tool for legislators in different member states[147].

EMCA recognizes the group interest and broadly follows the *Rozenblum doctrine*[148]. The act also includes the parent's right to give instructions to the subsidiary[149] subject to the exception

[139] See the rule established in the case Kahn v. Lynch Commc'n Sys. - 669 A.2d 79 (Del. 1995), available at https://law.justia.com/cases/delaware/supreme-court/1994/272-1993-3.html.
[140] For more information on the developments in the EU see, 2011 European Commission "Report of the Reflection Group on the Future of EU Company Law", available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1851654 and "A Proposal for Reforming Group Law in the European Union – Comparative Observations on the Way Forward" – European Company Law Experts, European Business Organization Law Review, April 2017, available at: http://ssrn.com/abstract=2849865.
[141] See Tobias H. Troger, "Corporate Groups", SAFE Working Paper No. 66 September 22, 2014, p. 13.
[142] 2011 European Commission "Report of the Reflection Group on the Future of EU Company Law" advised that "*The EU Commission should consider, subject to evidence that it would be a benefit to take action at the EU level, to adopt a recommendation recognising the interest of the group*" See p. 59.
The report is available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1851654;
[143] See Martin Winner, "Group Interest in European Company Law: an Overview", Acta Univ. Sapientiae, Legal Studies, 5, 1 (2016), p. 94.
[144] Information on the EMCA group and the EMCA project can be found here: http://law.au.dk/en/research/projects/european-model-company-act-emca/;
[145] See The Informal Company Law Expert Group (ICLEG), Report on the Recognition of the Interest of the Group, October 2016, p. 10.
[146] EMCA, 2017, 1st Edition, p. 1, available at: https://ssrn.com/abstract=2929348.
[147] See Martin Winner, "Group Interest in European Company Law: an Overview", Acta Univ. Sapientiae, Legal Studies, 5, 1 (2016), p. 94.
[148] EMCA, 2017, 1st Edition, Section 15.16.
[149] Id., Section 15.09.

applicable to independent directors, employee representatives and directors who were not appointed by the parent company or by the controlling shareholder.[150]

To balance the wide leeway afforded to the parent, EMCA includes various measures to protect shareholders and creditors.[151]

4 Situation in Georgia

Group Law is almost non-existent in Georgia. There are no systematic rules designed to regulate corporate groups. There are several provisions dispersed in different fields like tax law, competition and accounting. The rules set forth in the corporate law apply to groups as they apply to a single company.

Similar to the legal framework, theoretical research in this filed is also scarce. Only one literary source published in 2015 can be found in Georgian databases.[152] Nothing new has been written on this subject since. This is unfortunate considering the fact that corporate group and not a single company is the mainstream in today's commerce.

Unlike other sources of law, court practice on corporate group issues have recently proliferated. Certain amount of court decisions have accumulated. These decisions evidence the adverse effects of lack of regulation and demonstrate the need for systematic approach.

As stated in the EMCA, "*the group of companies, being an economic reality and being also dealt with in many other legal branches, should also be recognized and regulated by Company Law"*[153]. This holds true with respect to Georgia as well. As we will see from following parts of this paper, deficiencies in this body of law already cause confusion and uncertainty. It is time Georgian Corporate Law caught up with reality and created systematic rules regulating corporate groups.

To this end, this part of the paper first discusses existing legal framework in Georgia, demonstrating how the related concepts are defined in law (if any) and practice, moves on to discuss the issue of the group interest and follows it up with the issues of minority and creditor

[150] Id., Section 15.09, para. (3).
[151] For example, Section 15.12 (right of information and to request a special investigation), 15.14 (right of a shareholders to request a special investigation), 15.15 (right to sell-out), 15.17 (parent liability).
[152] "Governance of Corporate Groups in Germany and United States of America and Integration of Governance Principles in Georgian Private Law", a doctoral thesis of the professor Sofio Machavariani, published in Tbilisi, 2015; Available at http://press.tsu.ge/data/image_db_innova/disertaciebi_samartali/sofio_machavariani.pdf.
[153] See EMCA, 2017, 1st Edition, p. 373.

protection. At every stage, problems and deficiencies existing in our legal system will be outlined and recommendations will be offered for further development.

4.1 The Relevance of Corporate Groups

The trend to prefer the organization of business as a web of related companies, rather than a single company is present in Georgia as well. Most of the biggest and wealthiest companies in Georgia are part of Corporate Groups.

Socar Energy Georgia, the most profitable company in Georgia based on Forbes' 2021 statistics[154], is a subsidiary of the Azerbaijani state owned company[155], while itself has five wholly owned subsidiaries[156]. Toyota Caucasus, Tegeta Motors, Rompetrol Georgia, PSP Parma and Nikora are several of the numerous well-known names that are also part of the group[157], as well as in the top ten of the Forbes' statistics. Some companies even include the indication of the Group in their corporate name, like Georgia Healthcare Group, GT Group, Georgian Industrial Group etc. [158]

It is evident that Corporate Groups are just as relevant in Georgian reality as in the rest of the world. This applies not only to the nation-wide companies, but also to the international and foreign-based companies that have their subsidiaries established in Georgia.

This further strengthens the case for the regulation of corporate groups. Moreover, the desire of the country to attract foreign capital and make the business environment convenient to investors necessitates concrete and coherent legal framework for the major players in today's business (corporate groups).

4.2 The Concept of Corporate Group

4.2.1 Legal Framework

Legal framework in Georgia does not include a comprehensive and systematic regulation of groups. There are several laws that encompass some aspects of group regulation. Here I will discuss each of them in turn to demonstrate how the major concepts are defined and understood.

[154] See, 150 Most Profitable Companies in Georgia, available at https://forbes.ge/saqarthvelos-150-qhvelaze-shemosavliani-kompania/.
[155] See the Registry Extract available at https://bs.napr.gov.ge/GetBlob?pid=400&bid=boVlyOwlsX3qmYsntmLmFK02yWTGOBx6lb0fB1YsxdiESWr1ipnwP03du6DnKgm].
[156] See the information available in the Registry at https://enreg.reestri.gov.ge/main.php?m=new_index.
[157] See Registry Extracts.
[158] See Registry Extracts.

Law of Georgia on Entrepreneurs does not consider the corporate group as a separate, note-worthy phenomenon. Rules set forth with respect to a single company apply to groups just the same.

Neither the current nor the new version of the law mentions or defines a corporate group. Although they both mention the "subsidiary" and establish certain specific rules in this regard. The current version of the law deals with the subsidiary company in two articles – Article 14^4(6) and Article 53^5.

Article 14^4 sets forth the rules on the reorganization of an enterprise establishing that the shareholder's decision to reorganize an enterprise shall be subject to the registration and notice procedures stipulated in Article 14(3 and 4) of this Law. Registration and notice procedures consider the interests of the creditors of the company and requires the notification of the Revenue Service, as well as other creditors of an enterprise stating the timeframes for satisfying the creditors. From the moment of receipt of notice to completion of the reorganisation process, creditors can request from the enterprise to fulfil its obligations ahead of time[159]. The law includes an exception to this rule stating that - "*under the changes in the legal form of an enterprise, during which the capability of the enterprise to satisfy its creditors does not decrease, as well as if the enterprise takes over its 100% owned subsidiary, the publication and notice procedures … shall not apply"* and the creditors are not entitled to exercise the power mentioned above.

From the disposition of this rule, we can see that the legislator puts taking over a 100% owned subsidiary on the same level as the situation "*during which the capability of the enterprise to satisfy its creditors does not decrease".* Hence, no longer sees the necessity to protect creditors.

It is interesting what this assumption is based on. It is without question that the parent and the subsidiary are two different legal entities, with their own assets and liabilities. Allowing the parent company to take over its subsidiary without necessary notification and registration procedures overlooks this crucial aspect of separate legal personality. The lawmaker assumes that abolishing the separate legal personality of the subsidiary will not affect the financial standing of the enterprise and its capability to satisfy its creditors.

In practice, such reorganization can affect the interests of both the creditors of the parent and the subsidiary. In such circumstances, the creditors of the subsidiary would have to compete with the creditors of the parent while before reorganization they did not have to worry about

[159] Article 14^4 (8) of the current version of the Law.

the assets and the liabilities of the parent. The same is true for the creditors of the parent. Another aspect, which must be reinforced here as well, is that the parent and the subsidiary have independent assets and liabilities. How reorganization would affect the overall position of the company is uncertain and unknown to the creditors.

This article disregards the separate legal personality of the subsidiary that is 100% owned by the parent and by doing so puts the interests of the creditors of both companies under risk. Considering the specific characteristic of the parent-subsidiary relationship that itself blurs the line between two different, but related companies, the major challenge of the group law is deciding when to uphold that line and when to disregard it. Because of this, it is important to have a systematic approach whether to uphold the autonomy of the subsidiary or not. Transparency and the interest of the affected parties must necessarily be considered in this process.

Another provision that deals with the subsidiary is Article 53^5 (purchase of company's shares by a subsidiary enterprise). Under the Article if a reporting company[160] whose securities are admitted for trade on a stock exchange owns 50% or more than 50% of shares of another enterprise, such subsidiary enterprise shall not have the right to purchase shares of the reporting enterprise. This provision both prohibits the cross-ownership of shares and sets forth the definition of the subsidiary. Under the current legal framework, the company is a subsidiary if another company owns 50% or more of its shares. This definition is purely factual and takes the ownership of certain amount of shares the sole benchmark. Hence, unnecessarily narrows the scope of the parent-subsidiary relationships.

These are the only instances the current version of the main legal document in corporate law deals with the group. The new version of the law is not much different in its approach towards corporate groups. Subsidiary is mentioned only several times in the law and is never defined or regulated.

Under Article 142(3) a limited liability company's own shares and shares owned by its subsidiary enterprises will not be taken into account when counting votes, distributing property, dissolution or for the purposes of exercising other rights related to shareholding. The similar

[160] Under Article 9(1) of the Law of Georgia on Securities Markets, "*a reporting company (issuer of publicly held securities) is a legal person established under the Law of Georgia on Entrepreneurs, which has issued publicly held securities (except for covered bonds)*"; online version of the law is available at https://www.matsne.gov.ge/document/view/18196?publication=37.

provision exists with respect to JSC stating that rights cannot be derived from the ownership of the company's own shares and shares belonging to the subsidiary.[161]

The law of Georgia on Securities Markets also deals with some group-related aspects. Firstly, it provides the definition of the subsidiary company that uses the same criterion as the law of Georgia on Entrepreneurs – the ownership of 50% or more shares. It also defines the term "consolidated financial statement" – financial statement that contains financial statements of both a parent company and its subsidiary (subsidiaries).

The only legal document that sets forth the definition of a group is Law of Georgia on Accounting, Reporting and Audit. It also includes the definitions of a subsidiary and a parent. Under the law, a parent enterprise is "*an entity that controls one or more subsidiary enterprises*"[162]; subsidiary enterprise is *"an entity that is controlled by a parent enterprise, including by a subsidiary enterprise which represents a parent enterprise"*[163]*;* and a group is *"a parent enterprise and all its subsidiary enterprises"*[164];

As we can see from these definitions, parent-subsidiary relationship here is linked to the existence of control. Control on the other hand is defined in accordance with the IFRS.[165] Control under IFRS is defined broadly (encompassing the power obtained through both voting rights and contractual arrangements) and in field-specific terms[166].

Another legal document relevant in this regard is the Law of Georgia on Investment Funds. The law firstly states that it does not apply to holding companies[167] and then sets forth its definition. Pursuant to this definition, holding company is a company with shareholdings in one or more other companies, the commercial purpose of which is to carry out a business strategy (business strategies) through associated companies, its subsidiaries, or through participations in order to contribute to their value in the long-term, and which meets the conditions prescribed by the same provision. This definition evidences that the "Corporate Group" and the "Holding Company" are not the same concepts.

[161] Article 161(2) of the new version of the Law.
[162] Article 2(z^1) of the Law of Georgia on Accounting Reporting and Audit; Online version is available at https://www.matsne.gov.ge/document/view/3311504?publication=12.
[163] Article 2(z^2) of the Law of Georgia on Accounting Reporting and Audit.
[164] Article 2(z^3) of the Law of Georgia on Accounting Reporting and Audit.
[165] Article 2(z) of the Law of Georgia on Accounting Reporting and Audit.
[166] See IFRS 10 — Consolidated Financial Statements, available at https://www.iasplus.com/en/standards/ifrs/ifrs10;
[167] Article 1(4) of the Law of Georgia on Investment Funds.

Overall, legal framework in Georgia does contain the definition of the group and a holding company both of which are sector-specific. Despite this fact, they help to shape the general idea on these concepts. It is also obvious from above definitions that there are different approaches in terms of defying the term "subsidiary". The Law of Georgia on Entrepreneurs takes into account only the factual benchmark, the ownership of 50% or more, while the law of Georgia on Accounting, Reporting and Audit considers the idea of control as the relevant denominator. While it is acceptable to use terms in a different context for the purposes of different legislation, for the sake of legal certainty it is still advisable to have a coherent and systematic approach. Especially considering the fact that these areas of law are closely related.

Systematization of terms and concepts related to group is highly warranted. The place for such systematization is, of course, the Law of Georgia on Entrepreneurs, as this is the document that regulates the legal forms of the entrepreneurs and issues related to their activities.[168]

4.2.2 Court Practice

Corresponding to the prevalence of corporate groups in Georgia's economic reality, considerable amount of court decisions have accumulated in this field. It is interesting to discuss and assess the relevant concepts articulated by the courts.

4.2.2.1 The Earliest Decision

The earliest definition of the term "subsidiary[169]" is set forth in the Supreme Court decision of 2011.[170] The Chamber agreed with the definition set forth by CoA that the subsidiary is a company in which another company holds more than the half of voting rights or otherwise holds the power to control the operations of such subsidiary company.

Unlike the law of Georgia on Entrepreneurs, this definition combines both factual element of shareholding and the substantive element of control.

4.2.2.2 The Recent Decision

The latest case law on this matter is broader, more comprehensive and controversial. The recent (21 May 2021) Decision of the SCG[171] articulates on several different aspects relevant to this

[168] Article 1(1) of the new version of the Law of Georgia on Entrepreneurs;
[169] Definition of this term plays an important role in understanding the concept of the group and is more commonly used in legislation and court practice;
[170] Decision of the Chamber of Civil Cases of the Supreme Court of Georgia №AS-995-1028-2011, dated 15 December 2011;
[171] Decision of the Chamber of Civil Cases of the Supreme Court of Georgia №AS-1319-2018 , dated 21 May 2021;

paper. As I will refer to it on several occasions its preferable to provide a brief explanation of the facts of the case. In this part of the thesis, I will only cover the issues related to the overall essence of the group and will discuss the rest in relevant parts.

4.2.2.2.1 Facts of the Case

By the resolution of the shareholders company "P" established a subsidiary company "S" and transferred almost all of its assets in its charter capital. The resolution stated that the director of the company "P" was responsible for drafting relevant documents (charter and other) and registering the company in Registry. The minority shareholder (owner of the 20% of shares) of the company "P" initiated the claim against the company and two other shareholders and requested the annulment of the shareholders' resolution as well as the charter of the company "S". One of the main arguments stressed by the claimant was that transfer of assets from company "P" to company "S" leaves it unable to continue its business activities and make profit. The plaintiff argued that this considerably encroached on his/her rights as a shareholder.

4.2.2.2.2 Challenges with Terminology

When defining the relevant terms and explaining the parent-subsidiary relationship the chamber of cassation points out that, *"a subsidiary is a company that belongs to the other company, which is usually referred to as a "mother company" or holding company*[172]*".* "*Parent controls the subsidiary, which means that it owns or controls 100% or more than half of its shares*[173]*".* The court moves on to explain that a parent company buys or establishes the subsidiary in order to make use of increased tax benefits, diversified risks and so on. The chamber emphasizes that a subsidiary is an independent legal entity separate from the parent and notes that in its economic activities it is guided by the constitutional documents.

The chamber moves on to conclude that the *"company is considered to be the subsidiary if another company has the ability to determine its decisions through majority shareholding or contact or in other way. A "mother" company must hold more than 50% of shares in the company for it to be considered as a subsidiary*[174]*".*

There are several problems with this explanation. Considering that legal framework in terms of group law is almost non-existent in Georgia it is understandable that these definitions and explanations are contradictory and unsystematic as well.

[172] See para 134 of the Decision.
[173] Id.
[174] See Para 136 of the Decision.

Firstly, it is impossible not to notice terminological deficiencies: using different terms for the same concept, as well as using different concepts interchangeably. While court stipulates that the company who establishes the subsidiary is generally referred to as a "mother" company, itself refers to it as a "parent" in the next sentence. This may be purely technical but for the sake of legal certainty, it is always preferable to use coherent language when using the same concept.

Furthermore, the court uses terms "mother" company and holding company interchangeably, creating an assumption that the parent company and holding company are the same. The holding company is undoubtedly a parent company as well, but not all parent companies are holdings.

Typically, a holding company does not conduct any form of business activity: it does not manufacture anything, sell any products or services.[175] Rather, holding companies hold the controlling interest in other companies and maintain oversight over their functioning. Unlike corporate group, the Georgian law does provide the definition of the holding company, which also makes it clear that there is a distinction between these two concepts. It is important that courts acknowledge this difference and use appropriate terms in relevant circumstances.

4.2.2.2.3 Definition of the Subsidiary

Most important contradiction in court's explanation relates to the definition of the subsidiary. Initially court states that the *"parent controls the subsidiary, which means that it owns or controls 100% or more than half of its shares",*[176] afterwards it explains that *"the company is considered to be the subsidiary if another company has the ability to determine its decisions through majority shareholding or contact or in any other way".*[177] Finally, the court concludes by stating that a parent company *"must hold more than 50% of shares in the company for it to be considered as a subsidiary".*

In the first sentence, the court presupposes that control and the ownership of the majority of shares are the same. In reality, this is not the case. As mentioned before, majority shareholding is only one of the ways to establish control. In the second sentence, court does acknowledge this fact, stating that an influence can be exerted through contract or other means. In the last sentence, however, the court fully disregards the previous statement and concludes that

[175] See, Willyard Kate, *"Explaining Changes in Organizational Structure: Economic Theory, Political Theory, and Institutional Theory Perspectives",* Academic blog, 1/18/2016, available at http://www.katewillyard.com/academic-blog/explaining-changes-in-organizational-structure-economic-thoery-political-theory-and-institutional-theory-perspectives.
[176] See para. 134 of the Decision.
[177] See para. 136 of the Decision.

ownership of more than 50% of shares in necessary for a company to be considered as a subsidiary.

It is evident that the court confuses factual and substantive control. As mentioned above the factual control is the ability to determine the decisions of another company through the ownership of more than 50% of shares, while the substantive control is to exert influence through any other means. Both ensure the ability to determine the decisions of another company and that is what actually constitutes the cornerstone of the definition of control. Limiting parent-subsidiary relationships solely to the factual criterion of owning more than 50% of shares significantly reduces its scope and negates the reality. The reality that the court itself acknowledges.

4.2.2.2.4 The Nature of the Corporate Group

Another important issue that the Decision demonstrates is that understanding the nature of the corporate group is a challenge to our legal system. The main reason that leads me to make this conclusion is court's inability to comprehend the fact that the subsidiary is an independent legal entity separate from its shareholders.

In its deliberations, the court rightly notes that the *"subsidiary differs from the branch in that it is a legal person, which can have rights and perform obligations on its own name, be the claimant or the defendant in a dispute".* [178] The court also rightly states that the subsidiary is a legal entity independent from its parent. This means that a parent and a subsidiary are two different companies, with their separate assets, liabilities and shareholders.

Shareholders of the parent company participate in the management of the parent and make relevant decisions through the shareholders meeting. While, their decision definitely is the basis for the establishment of a subsidiary, they are not its shareholders. The shareholder of the subsidiary is its parent company. The separate legal personality creates that line between the subsidiary and the parent.

The court blurs this line several times in its decision failing to acknowledge its full implications.

When discussing the ability of the legal person to own property, the court explains that property of a legal entity is different from the property of its insiders and a legal person is not a property in the hands of its insiders.[179] Despite the fact that the court emphases this important aspect of what the legal personality means, itself diminishes it by stating that *"the subsidiary company,*

[178] See para. 135 of the Decision.
[179] See para. 131 of the Decision.

as a general rule, is an asset of the parent company" [180]. A subsidiary company just like any other legal entity is itself a subject of law and should not be viewed as someone else's property.

This is not the only instance court blurs the line between the parent and the subsidiary created by the separate legal personality. When deliberating on whether the establishment of a subsidiary has adversely affected the legal position of the minority shareholder of the parent, it points out that the resolution did not affect the rights of any of the shareholders of the company because *"as stated in the charter of the subsidiary, company "P" is the sole founder of the company "S", with the same share participation, without restricting shareholder's rights"*[181].

This entry in the subsidiary's charter hardly makes any sense. The fact that company "P" is the sole founder of the company "S" is clear, but what is meant by *"with the same share participation"* is completely dubious. It creates the assumption that the company "P" established the company "S" with the share participation of its shareholders. This does not make sense, because as stated above the only founder and the shareholder of "S" is "P". The court itself emphasizes this in the Decision.[182] Shareholders of the parent company do not have any direct stake in the subsidiary.

CoA even directly states in its deliberations that *"the plaintiff, as the 20% shareholder of the defendant and therefore 20% shareholder of the company"* "P"[183] …

Unsurprisingly, the court practice in this field follows the trend of inconsistency and contradiction existing in legislation. Having nothing in the primary sources of law SCG bases its deliberations on several different sources that reflect different approaches, hence the contradictions in the decision. The concept of the group seems to be novel and not fully comprehended by the courts.

4.2.3 Summary

In light of the above, we can see that there is no systematic approach with respect to groups in Georgia. The Law of Georgia on Entrepreneurs is the main legal document in corporate law and does not include any type of rules or directions for the most prevalent organizational form – corporate group. Some definitions are set forth in different legislation, but they are mostly inconsistent. It is advisable that law on Entrepreneurs include the systematic definitions of

[180] See para. 144 of the Decision.
[181] Id., para 143;
[182] Id., para 151;
[183] Id., para 48;

concepts like "Subsidiary", "Control", "Corporate Group" and "Holding Company". It is also advisable to define control broadly, encompassing both substantive and factual control.

This would create the coherent legal basis for courts as well and decrease the risk of vague and contradictory interpretations.

4.3 Group Interest

Recognition of the Group Interest is one of the major aspects when talking about the efficient group integration. The EU Commission has identified excessive legal impediments to group integration where Member States' corporate laws safeguard the subsidiaries' "self-interest".[184] Critical areas where strictly persistent status of subsidiaries as separate legal entities may impede efficient group integration are, for instance where parents seek to establish group-wide compliance and risk-management organizations[185] or group-wide standards and policies.

Recognition of the Group Interest is merely a legal acknowledgement of the economic reality. SCG in the Decision states that even though subsidiary is an independent legal entity, its will depends on the will of its founder, which is expressed through the shareholder's resolution.[186] Court continues to explain that the parent company manages the subsidiary through its (subsidiary's) governing bodies, as the direct management would contradict the principle of independence of the legal entity.[187]

This demonstrates that influence of the parent on the management of the subsidiary is a common place. Refusing to recognize this right by law is a mere formality and creates confusion, uncertainty and risk for the directors of both the parent and the subsidiary. As mentioned above it also hinders efficient group integration, impeding the parent's ability to utilize the benefits of the group structure.

The Law of Georgia on Entrepreneurs follows the traditional approach at present – directors owe their fiduciary duties to the company that they serve.[188] Although one of the decisions[189] in our court practice contradicts this stance and contains some elements of the group interest.

[184] See Tobias H. Troger, "Corporate Groups", SAFE Working Paper No. 66 September 22, 2014, See the citation: 2012 Action Plan, supra note 17, at 14-5 (para 4.6).
[185] See Tobias H. Troger, "Corporate Groups", SAFE Working Paper No. 66 September 22, 2014, p. 38.
[186] See para. 136 of the Decision.
[187] Id.
[188] See Article 9(6) of the current version of the Law and Article 50 of the new version of the Law;
[189] See the Decision of the Civil Cases Collegium of the Tbilisi Court of Appeals №2B/1424-17, dated 25 October 2017;

In this case, the court completely excluded director's liability because he/she coordinated his/her actions with the majority shareholder of the parent company. The case concerned a dispute between the company (the plaintiff) and its former director (the defendant) for the compensation of damages. The plaintiff argued that it suffered damage as the result of incorrect calculation of profits and losses and issuance of unreasonable bonuses to the employees.

The court explained that incorrect calculation of profits and losses by the electronic program and giving bonuses to employees would not be considered as the violation of the duty of care and would not lead to the imposition of financial liability to the directors, if it has been established that on all matters the director of the company did not make decisions individually, rather in agreement with the controlling shareholder and the director of the parent company, who was actively involved in the management of the subsidiary.[190] The court continued to point out that the duty of care would have been violated had the director of the subsidiary not informed its parent regarding the errors of the electronic program and had not attempted to cure the defects this way.[191]

This is the very important and interesting decision. It derogates from the traditional approach on the fiduciary duties of the director and acknowledges the management of the subsidiary according to the parent's direction, holding the director of the subsidiary harmless of liability.

Duty of care under Georgian law obliges the director to act with the belief that his/her actions are the most beneficial to the company. If the compensation of damages is necessary, the liability of the director does not cease just because he/she acted at shareholder's direction.[192] Under this legal framework, the director carries out its activities within his/her own responsibility and is not allowed to use shareholders' direction as a defence. This is logical, considering that director's full and excessive obedience would diminish its position and status to the extent that corporate governance in such organizational form would lose its meaning[193].

Decision of CoA contradicts this view and restricts director's liability because he/she coordinated his/her actions with the director and the majority shareholder of the parent company. Such attitude can be dangerous, considering that it holds the director harmless of all liability and makes the company susceptible to abuse from the parent company.

[190] Id., section 4.
[191] Id.
[192] Article 9(6) of the current version of the Law.
[193] See Burduli I., "For the Issue of Liability of the Director", Official Journal of the Georgian Bar Association My Advocate, N2, November, 2019, p.53.

This decision demonstrates that the economic reality has lead the court to restrict director's liability despite the fact that such possibility was not provided by law. Such derogations create uncertainty and the risk of unequal treatment of similar cases. Because of this, it is advisable to acknowledge the Group Interest by law and provide relevant safeguards for affected parties.

It is important that directors of both parent and subsidiary are aware of their legal position so that they can act accordingly. Acknowledging the group interest would provide such certainty. This would clarify the duties of the board. At the subsidiary level, it would allow the directors of the subsidiary company to take into account, within certain limits, the interest of the company as part of the group, which reflects what many subsidiaries are often, in practice, asked to do. Furthermore, it would create more flexibility for foreign companies managing their subsidiaries in Georgia and therefore attract more investments.

However, in order to protect the interests of the creditors and the minority shareholders of the subsidiary, certain balance must be maintained between the interests of the parent and of the subsidiary. Hence, the provision regulating the group interest must be carefully drafted considering the broad international experience that has already been accumulated.

Another important aspect that stems from the recognition of the group interest is the right of a parent company to give binding instructions to the subsidiary. This would reconcile law with the reality by treating subsidiaries in a different way than single, independent companies.[194] As well as, aid the flexible management of the group and bring to light what is already happening behind closed doors.

Such right of course would be subject to certain restrictions and limitations. It is not advisable to give directors of the subsidiary a green light for any decision disadvantaging the subsidiary, relieving them from all liability. To avoid such negligence EMCA proposes that the rule does not apply to independent directors[195] and that it is limited for the protection of outside shareholders (see more in 4.4.2.).

4.4 Minority Protection

4.4.1 Minority Shareholders of the Parent Company

As discussed in section 3.1 of this paper, in a group of companies, the agency conflict may also concern the minority shareholders in the parent corporation. The Decision of SCG illustrates this point.

[194] See EMCA, 2017, 1st Edition, p. 379.
[195] See Section 15.09(3) of EMCA.

There are three aspects concerning the minority shareholders of the parent company that I want to emphasize here: information rights, the right to take part in the organization of the company through its charter and the right to exit the company.

4.4.1.1 Information Rights

The plaintiff in the Decision partly based his/her claim on the argument that the establishment of the subsidiary company and the subsequent transfer of the assets of the parent to the subsidiary adversely affected his/her interests. CoA agreed with this point. However, SCG dismissed it and overruled the decision.

CoA in its deliberations pointed to the shareholder's right to request information on the company's business from the director and review the books and records of the company.[196] The court rightly noted that the plaintiff would be restricted from using this right with respect to the subsidiary.[197] The reason for this is that the sole shareholder of the subsidiary is its parent company, represented by the director. For the shareholder of the parent company to request the relevant information in the subsidiary he/she would need to convene the shareholders meeting, to adopt the relevant resolution. The minority shareholder of the parent company alone will not be able to use this right, as he/she is not the shareholder of the subsidiary.

The disposition of this right is clear and direct and only covers the right of the shareholder of the company on which the information is requested. Similar provisions exist with respect to the shareholder's right to request special investigation.[198]

Of course, the shareholder of the parent company can address the director for relevant information on the subsidiary; however, this article gives the director a ground to refuse the request, stating that the information belongs to the subsidiary company.

It is important that minority shareholder rights are not side tracked in corporate groups. Hence, legislative intervention is necessary to revise these provisions so that the right to information and the right to request special investigation reaches through the different layers of the group. To avoid any type of uncertainty, express provision to that end is advisable. This would prevent the management from refusing to answer questions about the situation of the group as a whole on the basis that the information is located at the subsidiary level.

[196] Article 46(4) of the current version of the Law. For similar information rights in JSC see Article 53; See Articles 146, 172, 173 for similar provisions in the new version of the Law.
[197] See para. 47 of the Decision;
[198] Article 53.3[2] of the current version of the Law. See Articles 174 for similar provisions in the new version of the Law.

4.4.1.2 The Charter of the Company

The charter is the main document defining the organizational and financial structure of the company.[199] It is an agreement allowing the members to regulate vast majority of relationships and create internal legal framework for their organization. However, the founders of the company (especially in Georgia) often disregard this opportunity, opting for the standard charter that merely transcripts the provisions of the law.

In the group context, this might cause the irrelevance of the most of the provisions of the charter. Where the function, organization and management of the company completely differ from what is set forth in the main constitutional document of the company.

Discussed Decision also includes some provisions demonstrating this point. For example the provision which states that decision on all essential matters related to the entrepreneurial activities are made by the majority vote of the shareholders present at the meeting.[200] Another provision states: *"the shareholder controls the management of the company through the shareholders meeting"*[201]. Similar provisions stipulate that the partner is obliged to perform the shareholder's resolution or otherwise will be excluded from the company.[202]

None of these provisions even acknowledges that the only shareholder of the subsidiary company is its parent company represented by its director. Wholly owned subsidiary does not have a shareholder's meeting it has one shareholder. This is one of the most important aspects with respect to groups and is the cornerstone of the majority of the issues related to the management of the subsidiary. In light of the economic reality of the group structure, the provisions of the charter are completely irrelevant.

This, once again, demonstrates the point made earlier in the section that the nature of the corporate group is not understood in Georgian reality. In this case, neither the court, nor the shareholders of the company acknowledge the separate identity of the subsidiary. The court discussed these provisions without even acknowledging their irrelevance simply removing the line between the parent and the subsidiary. Court treated these provisions as if they referred to the shareholders of the parent company and not the subsidiary.

[199] See Chanturia L, "Charter Autonomy in Corporate Law", p. 561, available at https://www.tsu.ge/data/file_db/faculty-law-public/sam&politik%20narkvev1.pdf;
[200] See para. 41 of the Decision.
[201] See para. 47 of the Decision.
[202] Id.

This shows the lack of understanding of major issues of corporate groups. To avoid this it is advisable that the agreement on some essential aspects become the mandatory part of the subsidiary's charter.

One of such essential aspects is the regulation of parent-subsidiary relationship. An immediate way for this is the preparation of the charter - defining the relevant organizational and financial matters therein. Besides the content, what is important here is who makes decision on these issues.

Shareholders of the parent company are the ones making the decision to establish a subsidiary and they should be the ones to decide the key organizational and financial issues. It is important that shareholders of the company understand this point and make relevant decisions when establishing the subsidiary.

This matter is most problematic with respect to minority shareholders. The Decision illustrates why. To recall the facts of the case - the resolution of the parent company merely expressed the shareholder's will to establish the company and instructed the director to prepare relevant documents and register the company. The director prepared the charter and registered the company with himself/herself as the director.

The plaintiff argued that the resolution was not enough and an additional meeting was necessary to establish the terms of the charter and decide the relevant issues.[203] He/she argued that the director was solely instructed to submit the charter in the Registry and not to prepare and approve it.[204] The plaintiff also argued that there was no agreement between the shareholders on who was supposed to be the director of the subsidiary[205].

SCG dismissed the plaintiff's contentions stating that if the shareholders instructed the director to prepare the relevant documents and register the company, there was no necessity to hold an additional meeting.[206] Under Article 3(4^1) of the current version of the law the *"partners conclude an agreement (charter) governing matters related to the business of the enterprise and/or relations between the shareholders"*. The court emphasized that the sole shareholder of the subsidiary was its parent company[207] and even without the relevant instruction, the director

[203] See para. 42 of the Decision.
[204] See paras. 67 and 68 of the Decision.
[205] See para. 70 of the Decision.
[206] See para. 149 of the Decision.
[207] See para. 151 of the Decision.

of the parent company was obliged to enforce the resolution and submit the charter in the Registry.[208]

Unfortunately, the court does not make a distinction between the procedural and substantive aspects of preparing the charter and registering the company. It is without question that the director of the parent is the one responsible to submit the relevant documents and register the company, but does it mean that the director has the power to decide the content of the charter or who should be appointed as the director of the company?

The court did not go into the further detail on this issue. The Decision does not include any discussion on what the shareholders must decide exclusively and what can be within the discretion of the director. Furthermore, the court did not view the effect on the minority shareholder's interests in this respect. Considering that the director of the company will be influenced by the majority, it is plausible and even expected that the director will draw up the charter in the interests of the majority.

This can be problematic, especially in light of the role that the charter plays in life of the company. On one hand the court points out that the *„respect for the shareholder's rights and the interests of the enterprise is a prerequisite for the successful operation of any company. Shareholder's agreement (the charter) in which they agree to establish the company is the legal basis for the respect and protection of these obligations.*[209]*"* On the other hand diminishes the preparation of a charter to a mere formality.

One way that this issue can be resolved is by setting forth additional mandatory requirements for the charter that the parent company would necessarily have to consider when establishing the subsidiary. As well as establishing that shareholders of the parent company should deliberate on these essential provisions of the charter. If they desire to delegate this function to the director of the company they must expressly state it in their resolution and nevertheless approve the charter that the director has prepared.

This will be helpful in several ways. First, it will give shareholders an opportunity to discuss and decide the most important issues of group organization and management. This way the charter of the subsidiary will actually be relevant. Second, shareholders will have to elaborate on the function of the group and the rights of the shareholders with respect to subsidiary. In this

[208] See para. 164 of the Decision.
[209] See para. 152 of the Decision, see the citation: Burduli I., Fundamentals of Joint Stock Company Law, Volume II, Tbilisi, 2013, p. 157;

case, minority shareholders will have relevant information regarding the future of the company and a venue to express their concerns.

4.4.1.3 Appraisal Rights

Such framework would strengthen the position of minority shareholders of the parent company, but in order to provide the full protection, minority shareholders should have the ability to exit the company if they disagree with the decision to transform a single company into a corporate group. One of the ways to do this is by providing the dissenting shareholders with a right to require the company to buy out their shares, so-called appraisal rights.

The appraisal remedy is the product of common law.[210] It was established to balance the broader leeway afforded to the majority shareholders in making decisions. Back then, shareholder's unanimous consent was required for major changes to corporations (assets sales, charter amendments and consolidation).[211] All shareholders had to agree on such changes, considering that these events considerably affected their original expectations regarding the operation of the business.[212]

Unanimous consent seriously impeded corporate development by hindering business restructuring and expansion.[213] As a result, statutes finally granted broader powers to the majority shareholders to decide upon such major changes.[214] Such majority rule deprived minority shareholders of their veto power.

Considering that appraisal right was created to protect the minority shareholders whose veto powers have been taken away and to *"offer liquidity to shareholders when fundamental changes occur"*[215], it is logical that minority shareholders not wishing to transition from a single company to the corporate group have the ability to exercise it.

Current legal framework in Georgia includes such right but only for JSC-s.[216] A shareholder may request the company to evaluate and redeem his/her shares if he/she, at a general meeting,

[210] See Groningen R. "Exit Remedies For Minority Shareholders in Close Companies", Kluwer, Deventer 2011, see the citation: Melvin Aron Eisenberg, Corporations and Other Business Organizations, Eighth Edition, Foundation Press, 2000, p. 1072.
[211] Id., see the citation: Arthur R. Pinto & Douglas M. Branson, op. cit,. Chapter 6.
[212] Id., see the citation: Arthur R. Pinto & Douglas M. Branson, op. cit., Chapter 6, p. 127.
[213] Id., see the citation: 12 B Fletcher Cyclopaedia of Private Corp. S. 5906. 10. Appraisal Rights of Shareholders, p. 1, see also Principles of Corporate Governance: Analysis and Recommendations, American Law Institute, 1994. Part VII, Chapter 4, The Appraisal Remedy, p. 291.
[214] Id., see the citation: 12 B Fletcher Cyclopaedia of Private Corp. S. 5906. 10. Appraisal Rights of Shareholders, p. 1.
[215] Id., see the citation: Melvin A. Eisenberg, The Structure of the Corporation: A Legal Analysis, 77-79, 1976.
[216] See Article 53^1 of the current version of the Law and Article 179 of the new version of the Law.

has not supported the decision that substantially violates the shareholder's rights, or is related to reorganisation of the enterprise. It must be noted here, that the new version of the law provides similar right to the shareholders in LLC as well. Under this provision, a shareholder who opposed the decision on reorganization at a general meeting must be given 20 days period after the meeting to address the enterprise with a claim to repurchase his/her/its shares.[217]

From what we have discussed, it is obvious that transition from a single company into a corporate group is associated with several different issues and affects the position of shareholders to some extent. When such transition is carried out through consolidation or a merger, this would clearly be the reorganization of the enterprise[218] and the appraisal remedy would be available to the dissenter. However, it is not completely clear whether establishing a subsidiary would be considered as reorganization under Georgian law.

To amend this gap, it is logical to consider a corporate group as an independent organizational form. This way transition from a single company into a corporate group would be considered as a change in a legal form and therefore would fall within the scope of *"reorganization"*[219]. This would empower the minority shareholders of the parent company to participate in the establishment of the subsidiary and enable them to exit the company if they do not support the relevant resolution.

4.4.2 Minority Shareholders of the Subsidiary Company

As discussed in part 2 of this paper, main challenges with respect to minority protection are the following: transfer of value from the subsidiary to the parent, risks associated with the management of the member in the interest of the group; balancing of interests between different members of the group and the risks associated with the wedge between control of the majority shareholder and his/her/its financial stake.

Minority protection in this respect consists of three major points: right to information, right to exit the company and the protection to balance the recognition of the group interest.

4.4.2.1 Information rights

The lack of information is one of the main causes that aid and abet abusive behaviour. Empowering minority shareholders to obtain necessary information regarding the activities of

[217] Article 75 of the new version of the Law.
[218] See Article 14^4(1)(b) of the current version of the Law and Article 59(1)(b) of the new version of the Law.
[219] See Article 14^4(1)(a) of the current version of the Law and Article 59(1)(a) of the new version of the Law.

the company will increase the transparency of transactions involving the company and significantly reduce the associated risks.

The deliberations made with respect to minority shareholders of the parent company are relevant here as well. While the corporate law does ensure the minority shareholder's right to information, it is limited to the specific company. Even though the financial conditions of the member of the group are hugely affected by its position in the corporate group and therefore relevant information must be readily available at that level as well, existing corporate law provisions give grounds to the director of the subsidiary to refuse the information request stating that it belongs to the parent. This drastically affects the minority shareholder's ability to have a complete information on how the group is managed, what type of intra-group transactions are being concluded and so on. As well as restricts them to request special investigation.

This challenge can easily be resolved by revising the relevant provisions of the law to allow the minority shareholders of the subsidiary to request relevant information from the parent and enable them to request special investigation when there are sufficient reasons for suspicion.

4.4.2.2 Right to Sell Out

Although such information rights would greatly strengthen the position of minority shareholders, allowing them to have relevant information about the management of the group, this alone is not enough. Minority shareholder that are not satisfied with the management of the group may nevertheless be locked in the company even though they may want to *"jump the ship when the master sends it in a new direction*". [220] Hence, it is important that some type of exit mechanism is introduced in Georgian corporate law that would allow minority shareholders to exit the company upon appropriate compensation.

Similar *"sell out"* or *"buy out"* possibilities exist in several jurisdictions[221] and are commonly applied in take-over situations[222]. If the outside shareholders are not satisfied with the group management or believe that their interests are unduly disadvantaged, they will have the ability to obtain the relevant compensation and exit the company. Such right would also balance out

[220] See Groningen R. "Exit Remedies For Minority Shareholders in Close Companies", Kluwer, Deventer 2011, see the citation: Hideki Kanda & Saul Levmore, op. cit., p. 2;
[221] Like "reversed squeeze-out" in Poland (Section 418 of the Polish Companies Act); "right to be bought" in Portugal (Section 490 of Portuguese Companies Act); Hungary (Section 3:53 and 3:324 of the new Hungarian Civil Code); Italy (Article 2497 of the Italian Civil Code);
[222] See Article 16 of the Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids; available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32004L0025;

"squeeze-out" rights of the majority, allowing the minority to decide when they want their shares to be bought out.

4.4.2.3 Protection to Balance the Recognition of the Group Interest

Another important aspect in terms of minority protection relates to the recognition of the group interest. As we have mentioned, such recognition allows the director of the subsidiary to act in a way contrary to the interests of the subsidiary. This puts the minority shareholders at a significant disadvantage. In order to balance this disadvantage it is important to define clearly in what circumstances directors can use the group defence. Approach set forth in EMCA (influenced by the French *Rozenblum* case[223]) can be used as a starting point.

Section 15:16 titled *"Interest of the Group"* contains several points that limit the possibility of the misappropriation of this right. First, the decision must be in the interest of the group as a whole[224]; the director can assume that the disadvantage will, within a reasonable period, be balanced by some kind of a benefit[225] and the disadvantage is not such as to threaten the continued existence of the company[226]. Furthermore, under this provision the director of the subsidiary may refuse to comply with the instructions from the parent if these conditions are not satisfied.[227]

This would limit the scope of the parent intervention and guard the subsidiary against abuse. Such framework, together with sell-out and information rights, would allow a flexible management of the group while simultaneously protecting the interest of the minority shareholders.

4.5 Creditor Protection

As discussed earlier in this paper, there are two main risks for the creditors in corporate groups: limited resource risk and debtor opportunism. The challenge in the first case is lack of knowledge regarding the financial position of the member of the group in light of the fact that lines between the members of the group are usually blurred. Intra-group branding and the involvement of representatives from different layers of the group in the transaction contribute to the misrepresentation of the assets of the group member in questions. The challenge in the

[223] See EMCA, 2017, 1st Edition, p. 386.
[224] Section 15:16(1)(a) of EMCA.
[225] Section 15:16(1)(b) of EMCA.
[226] Section 15:16(1)(c) of EMCA.
[227] Section 15:16(3) of EMCA.

latter case is associated with parent's broad scope of influence in subsidiary's affairs and the risk that assets might be transferred through intra-group transactions.

This paper proposes two possible tools to mitigate these risks: higher transparency of group structure and management and introduction of some kind of enterprise liability.

4.5.1 Transparency

It is important that persons transacting with members of the corporate group have the ability to evaluate its financial position and risk of default, so they can price their investments accordingly or even restrain from contracting at all. The major problem here is disconnect between legal and business reality. Most of the time the law gives much greater weight to the separate legal personality of group members than do their customers, supplier, investors and governments with whom they deal.[228] Even a group's managers and shareholders themselves disregard corporation's independent existence.[229]

The idea here is to require the group to disclose in an investor-friendly way its organizational form, structure and relationship between different members of the group. One way to do this would be to regard corporate groups as separate organization forms and require the relevant indication on the Registry extract of the company, similar to the indication of LLC and JSC. Further information on the organization and management of the group can be provided through the web site of the company. It is advisable that the degree of control and the scope of direction of a parent upon the subsidiary is also disclosed so that the creditors know to what extent the autonomy of the member is maintained.

A 2002 high-level EU group of company law experts made similar recommendation stating that the parent company of each group should be responsible for disclosing up to date information on group structure and relations.[230] It also emphasised that *"especially with respect to non-financial disclosure, it should be ensured that -- especially where listed companies are involved – a clear picture of the group's governance structure, including cross holdings and material shareholders' agreements, is given to the market and the public"*[231].

[228] See Westbrook, J. "Transparency in Corporate Groups", 2018, Brooklyn Journal of Corporate, Financial & Commercial Law 13, no. 1, p. 34.
[229] Id.
[230] See Corporate Governance of Company Groups: International and Latin American Experience, Latin American Roundtable, Task Force on Corporate Governance of Company Groups, 17 November 2014, para. 34.
[231] Id. see the citation: Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, Brussels, 2002, page 100.

Currently Law of Georgia on Accounting, Reporting and Audit is the main legal documents setting forth standards of disclosure for companies.[232] With respect to groups, it allows the submission of consolidated annual reports.[233] The law is based on IFRS[234] standards that are commonly known and accepted all around the world. Such disclosure does provide useful information but the question is whether the basic information on company's group structure is easily accessible.

Selective review of the consolidated annual reports of the biggest companies demonstrate that existing framework fails to suffice. This is not surprising, considering that there are no rules requiring the companies to describe main features of a company's group structure in a clear and investor-friendly manner.[235] Furthermore, consolidated financial reports mostly focus on the parent company and not the subsidiary.

4.5.2 Enterprise Liability

Enhanced transparency empowers creditors to be more informed when entering into transactions with the member of the group. However, it does not protect them from the risk that after the transaction has been concluded the parent will take advantage of the subsidiary's financial position. Neither does it protect involuntary creditors.

This paper does not attempt to propose that intra-group asset transfers be restricted. On the contrary, it acknowledges that such transactions can be highly efficient and beneficial to the group. This, however, does not mean that creditors of the company should be left unprotected.

What this situation requires is the introduction of some type of enterprise liability. As discussed above, the parent company has the right to issue instructions and oblige the subsidiary to transfer assets or provide services. To balance such wide scope of intervention in subsidiary's affairs, the rule on enterprise liability can require the parent that upon insolvency, if the subsidiary fails to repay outstanding debts as the result of such instructions, parent be required to pay the said amount.

In any case, such provision would disregard the separate legal personality of the subsidiary (entity principle) and treat two companies as one enterprise. Circumstance upon which the separate legal personality is to be disregarded must be carefully ascertained and formulated. One of the important aspects is the degree of control that the parent company exercises over the

[232] See Article 1 of the Law of Georgia on Accounting, Reporting and Audit.
[233] See Article 3(15) of the Law of Georgia on Accounting, Reporting and Audit.
[234] See Article 3(2)(a) of the Law of Georgia on Accounting, Reporting and Audit.
[235] Id. para. 35.

subsidiary. Overall, the business reality of a group must be taken into account, so that law does not become formalistic and uphold the autonomy of the subsidiary when its managers and shareholders take very little account of it.

Disregarding the limited liability is associated with the fear that such approach would hinder the economic growth, discouraging the investors and entrepreneurs to realize their undertakings. However, with respect to corporate groups such fears are unfounded. As Blumberg points out, most of the advantages of limited liability are valid only when "*interposed for the protection of the ultimate investors in the enterprise*[236]*. In most cases, these considerations simply become irrelevant when limited liability is interposed for the protection of corporate shareholders who comprise the upstream tiers in a multi-tiered corporate group."*[237] Blumberg further points out that limited liability meant the protection for the ultimate investors[238] and its application to groups of companies was incidental – merely a *"historical accident"*[239]. It was afforded to the parent without realization that the relationship of parent to subsidiary is different from the relationship of investor to the enterprise.

Blumberg is not alone in questing the application of traditional limited liability to corporate groups.[240] This, of course, does not mean that limited liability should altogether be disregarded in corporate groups. It simply demonstrates that its use can be restricted in certain circumstances.

Georgian law includes one mechanism for restricting the use of limited liability – piercing the corporate veil.[241] However, with respect to groups this mechanism is not particularly useful. Newest court practice demonstrated this point. The Supreme Court of Georgia decided two cases[242] in 2020 on the issue of piercing the corporate veil between the parent and the subsidiary. In both of these cases plaintiff argued that the representatives of the parent company were

[236] See also Hansmann H. and Squire R., "External and Internal Asset Partitioning: Corporations and Their Subsidiaries", The Oxford Handbook of Corporate Law and Governance, 2018, p. 251-74.
[237] Blumbeg P. I., *"Limited Liability and Corporate Groups",* 1986, Journal of Corporation Law, 11(4), p. 576.
[238] Id., p. 604.
[239] Id., p. 605.
[240] See Dickfos, j., "Enterprise Liability for Corporate Groups: A More Efficient Outcome for Creditors", Australian Journal of Corporate Law, 2011; J E Antunes, "Liability of Corporate Groups. Autonomy and Control in Parent-subsidiary Relationships in US, Germany and EU Law. An International and Comparative Perspective", Wolters Kluwer, USA, 1994.
[241] See the Article 3(6) of the current version of the Law and Article 26(2) of the new version of the Law.
[242] See the Decisions of the Chamber of Civil Cases of the Supreme Court of Georgia №AS-246-2020 dated 12 November 2020 and №AS-433-2020 dated 19 November 2020.

actively involved in negotiations and the conclusion of the contract, but untimely the contract was concluded with the subsidiary who did not own any property.[243]

SCG denied the claim explaining that company's 100% participation in another is not sufficient to pierce the corporate veil, although, in such circumstances control and ownership may be in the hands of one person.[244] Piercing the corporate veil requires the use of control for unlawful purposes – for the avoidance of statuary or contractual obligations, which is equivalent to the abuse of the corporate form.

This explanation corresponds to both the law and the practice and demonstrates that this mechanism is not relevant with respect to corporate groups. Piercing the corporate veil focuses on the abuse of the legal form, when the company is used as an instrument or alter ego of the shareholder.[245] This is rarely the case in corporate groups. Here intra-group transfers are common phenomena and serve the overall purpose of the group. This is why the introduction of a novel, specific tool is necessary to protect the creditors in corporate groups.

Conclusion

International, as well as national experience shows that the legislation drafted for a single company is not sufficient to deal with corporate groups. The group structure serves a specific purpose and function (see part 1 of this paper), which in certain circumstances requires the circumvention of the autonomy of its members. This gives rise to challenges that are different or more aggravated than in a single company (see part 2 of this paper). Different countries use different approaches to deal with these challenges. Some focus on the interests of the parties involved, while others on the flexibility of the group management (see part 3 of this paper). Others, like Georgia, do not have any specific regulation with respect to corporate groups at all.

The legal and judiciary framework in Georgia shows that there is a huge gap in our corporate law. While the law is silent and the companies' charters mostly irrelevant, courts faced with the consequences have nothing to base their judgements on. This creates uncertainty and confusion.

[243] See para. 13.2 of the Decisions of the Chamber of Civil Cases of the Supreme Court of Georgia №AS-246-2020 dated 12 November 2020.
[244] See the Decisions of the Chamber of Civil Cases of the Supreme Court of Georgia №AS-246-2020 dated 12 November 2020, para 19.9.
[245] See the Decision of the Chamber of Civil Cases of the Supreme Court of Georgia №AS-1307-1245-2014 and №AS-1158-1104-2014;

As demonstrated in part 4.1 of this paper, corporate groups are major business players in Georgian reality. The Court practice illustrates that there are number of disputes involving group related issues. The economic reality has evolved but the law legs behind.

This paper proposes to reconcile the law with the reality and regulate corporate groups through legislative intervention. Because the Law of Georgia on Entrepreneurs is the main document regulating the organization of entrepreneurs and their activities it is logical that corporate groups as well be regulated by this document.

Initially it is important to define group related terms in order to create a coherent and systematic framework (see part 4.2.3. of this paper). Business reality of corporate group demands the recognition of the group interest, considering that inability to manage the corporate group diminishes its whole function (see part 4.3 of this paper). As demonstrated in relevant parts of this paper, the position of the shareholders and creditors is also different in corporate groups. Because of this, it is important to revise certain provision to reflect this difference and introduce specific mechanisms for minority and creditor protection (see part 4.4 and 4.5 of this paper).

Such intervention will facilitate and enhance the flexibility of the formation, organization and functioning of the leading form of business organization without encroaching on the rights of minority shareholders and creditors.

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